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Supreme Court of the United States

OCTOBER TERM, 1940.

Nos. 408 - 409

CHARLES CROPLEY  
CLERK

CITY BANK FARMERS TRUST COMPANY, as Trustee of a  
Trust Under the Last Will and Testament of  
Angier B. Duke, Deceased, for the Benefit of  
ANTHONY NEWTON DUKE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

CITY BANK FARMERS TRUST COMPANY, as Trustee of a  
Trust Under the Last Will and Testament of  
Angier B. Duke, Deceased, for the Benefit of  
ANGIER B. DUKE, JR.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writs of Certiorari to the United States  
Circuit Court of Appeals for the Second Circuit.

ROLLIN BROWNE,  
20 Exchange Place,  
New York, N. Y.,  
Attorney for Petitioners.

JOHN G. JACKSON, JR.,  
GEORGE CRAVEN,  
MITCHELL, TAYLOR, CAPRON & MARSH,  
JACKSON, FULLER, NASH & BROPHY,  
New York, N. Y.,  
Of Counsel.

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---

**Petition for Writs of Certiorari to the United States  
Circuit Court of Appeals for the Second Circuit.**

The petitioners pray that writs of certiorari issue  
to review the judgments (R. 183, 185) of the United  
States Circuit Court of Appeals for the Second Cir-  
cuit entered in these cases on June 12, 1940.



### Summary Statement of Matter Involved.

In these cases there is presented to this Court for the first time the question of whether trustees' commissions are deductible as ordinary and necessary business expenses in computing net taxable income of the trust estates.

The Board of Tax Appeals and the Court of Appeals held that such commissions were not deductible because the administration of the trusts did not constitute "business" within the meaning of the income tax laws (R. 176). The Court of Appeals expressly based its decision on its earlier decision in *Higgins v. Commissioner*, 111 F. (2d) 795, now pending before this Court (No. 253) on a petition for a writ of certiorari. The petition for certiorari in the *Higgins* case is unopposed by the Department of Justice, which concedes that such decision conflicts with the decision of the Third Circuit in *Dupont v. Deputy*, 103 F. (2d) 257 and "probably cannot be reconciled with the decision of the Sixth Circuit in *Kales v. Commissioner*, 101 F. (2d) 35".

### Opinions Below.

The majority opinion (R. 36), the concurring opinion (R. 42) and the dissenting opinion (R. 43) of the United States Board of Tax Appeals are reported in 39 B. T. A. 29. The opinion of the Circuit Court of Appeals (R. 176) is reported in 112 F. (2d) 457.

### Jurisdiction.

Jurisdiction to issue the writs prayed for is vested in this Court by Section 240(a) of the Judicial Code,

as amended by the Act of February 13, 1925. The judgments of the Circuit Court of Appeals were entered on June 12, 1940 (R. 183, 185).

### **Questions Presented.**

1. Are the necessary and reasonable expenses of the administration of a trust for the investment and reinvestment of a fund of several million dollars and the accumulation and reinvestment of the income therefrom, including customary commissions of the trustee, computed in accordance with State law, deductible in computing the net taxable income of the trust estate, as "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"?

2. Has the repeated reenactment of the section of the revenue law providing for the deduction of ordinary and necessary business expenses established Congressional approval of the uniform and consistent administrative practice under which the deduction of trustees' commissions as business expenses always has been allowed?

### **Statute Involved.**

There are involved the following provisions of the Revenue Act of 1928:

#### **"SEC. 23. DEDUCTIONS FROM GROSS INCOME.**

In computing net income there shall be allowed as deductions:

(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a



reasonable allowance for salaries or other compensation for personal services actually rendered;

\* \* \* "

#### **Facts.**

The trusts were established under the will of Angier B. Duke, a New York decedent, one for the benefit of each of his sons (R. 65). The trustee of each trust was authorized to apply income for the support and education of a son and was directed to accumulate all income not so used, until the son reached his majority, whereupon the accumulations of income were to be paid over to him, the principal to be continued in trust for the benefit of himself and his descendants (R. 75-77).

The trusts were set up on February 26, 1926 by transfer from the executor of securities of the market value of over \$3,800,000 in the case of each trust (R. 71, 84, 86).

During the tax year (1931) the trust assets comprised a diversified list of securities aggregating over \$7,600,000 of principal, plus nearly \$2,000,000 of accumulated income, a total of nearly \$10,000,000. A complete list of investments was not introduced at the trial, but the trustee's ledger sheets reflecting the transactions during the tax year disclose that the funds were invested in at least sixty-five different bond issues aggregating \$3,500,000 face amount and at least eighteen different stocks aggregating 85,000 shares, a total of eighty-three different income-producing securities (R. 125-156).

The trustee was given wide discretionary investment powers and was not restricted to so-called legal trust fund investments prescribed by the New York statutes (R. 89-90). The trustee was authorized to

retain the investments received from the testator and was admonished that the property should be managed prudently and securely, "rather than hazarded in what may promise great gains" (R. 78).

The combined trust income of both trusts in 1931 amounted to over \$250,000, of which, after deducting distributions made for the support of the beneficiaries, over \$230,000 was accumulated for their benefit (R. 67, 68). The figures as to 1930 do not appear in the record, but up to the end of 1929, the trust income aggregated over \$1,900,000, of which over \$1,700,000 was accumulated and invested (R. 85, 87).

During 1931 the trustee made at least 47 security transactions, including 22 purchases, 19 sales and 6 redemptions (R. 125-156). The transactions during the earlier years do not appear in the record.

The Board stated in its opinion (R. 40) that the trustee's accounting showed only nominal expenses aside from taxes. The Board overlooked those expenses which were charged against principal under the New York law and which aggregated over \$25,000 (R. 84, 86) and ignored the trustee's commissions amounting to over \$76,000 computed on principal and over \$21,000 computed on income (R. 85, 87), which covered all the ordinary expenses, as well as the compensation, of the trustee.

The Board found (R. 36):

"The duties of the petitioner as trustee of the trusts consisted in general of causing its investment committee to review several times each year the securities comprising the corpus of the trust; selling securities and reinvesting the proceeds in other stocks and bonds; collecting interest and dividends on securities; paying expenses of the

trusts; distributing income to beneficiaries; keeping the books of account of the trusts; rendering statements to the interested parties; and preparing and filing income tax returns."

The Trust Officer in charge of the account testified that the investments held in these trusts were reviewed at least 2 to 4 times a year by an investment committee, in addition to weekly or monthly reviews by the investment clerk and the senior officer in charge (R. 107). In 1930 the trustee filed an intermediate accounting for the purpose of securing the Surrogate's instructions as to its investment powers and duties (R. 112).

Under Section 285 of the New York Surrogate's Court Act, a trustee is entitled to receive "for his services in such official capacity" commissions as follows: "for receiving and paying out all sums of money not exceeding \$2,000 at the rate of five per centum", and "for receiving and paying out any additional sums at lower graduated rates. Commissions computed on the amount of income received and paid out may under certain conditions be deducted from the income and paid to itself by the trustee. Commissions computed on the amount of principal received and paid out are allowable only on judicial settlement of the trustee's accounts.

Pursuant to the authority of that statute, the trustee has withheld from the trust income and paid to itself commissions computed on the trust income. In the tax returns which it has filed for the trusts such commissions have been claimed as deductions in computing the net income of the trust, and such deductions have uniformly been allowed by the Commissioner of Internal Revenue without question (R. 103, 111).



No commissions computed on the principal of the trusts were claimed by the trustee or allowed or paid to it until 1931, when its first judicial accounting was approved by the Surrogates' Court of New York County (R. 66, 87, 88). In that accounting the trustee was allowed commissions computed on principal amounting to \$38,641.71 in the Anthony N. Duke Trust and \$38,641.06 in the Angier B. Duke, Jr., Trust, which it duly paid to itself and charged to the principal of the trusts as required by the decree (R. 66, 67).

#### **Rulings Below.**

At the trial of the cases before the Board, counsel for the Commissioner in effect conceded that the administration of the trusts constituted business; he stated that the Commissioner had allowed the deduction of the trustee's ordinary income commissions and all other ordinary and necessary business expenses (R. 103). He urged, however, that the commissions on principal should not be allowed because they were not proper income charges, but represented large, unusual items of a capital nature (R. 103-4).

Nevertheless, in the brief which he filed after the trial of the cases, counsel for the Commissioner urged that the administration of the trusts was not a business and that the commissions in dispute should be disallowed on that ground, as well as on the ground stated at the trial.

The Board of Tax Appeals sustained the Commissioner. Seven members of the Board concurred in an opinion disallowing the commissions solely on the ground that the trustee's administration of the trusts was not a business (R. 36). Four members, in a separate opinion, concurred in that holding but also

justified the disallowance of the commissions on the ground that they were "non-recurring items chargeable to and deductible from corpus" (R. 42). Five members dissented (R. 42, 43).

The Court of Appeals affirmed, saying:

"We hold that in caring for the trust estate the trustee was like an individual engaged in investing his funds in stocks and bonds and that such a person cannot be regarded as engaged in business and, therefore, is not entitled to be allowed any deduction for expenses incurred in investing and supervising the estate" (R. 180).

"In spite of the practice of the tax department to treat such a trustee as though engaged in business we see no rational ground for distinguishing his position from that of a guardian, custodian or individual investor \* \* \*" (R. 182).

#### Specification of Errors.

The Circuit Court of Appeals erred:

1. In holding that the administration of the trusts was not the conduct of business within the meaning of Section 23(a) of the Revenue Act of 1928.

2. In upholding the Commissioner's contention that the administration of the trusts was not the conduct of business, despite the Commissioner's concession to the contrary at the trial.

3. In holding that the trustee's commissions in question were not "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business", within the meaning of said section.



4. In ignoring the long established and consistent administrative practice under which such commissions have been allowed as business expenses, and in failing to consider such practice controlling on the interpretation of the statute.

5. In approving the Commissioner's disallowance of the commissions in question and in affirming the decisions of the Board of Tax Appeals disallowing the claimed deductions.

#### Reasons for Granting the Writ.

1. These cases present merely a particular aspect of the general question involved in *Higgins v. Commissioner*, 111 F. (2d) 795.

The general question presented in the *Higgins* case is whether ordinary and necessary expenses incurred in the management and conservation of income-producing properties and the production of income therefrom are deductible as business expenses in computing net taxable income.

These cases involve two trusts for the investment and reinvestment of capital funds of several million dollars each and the accumulation and reinvestment of the income therefrom, and the question is whether the ordinary and necessary expenses of the administration of such trusts, including the trustee's commissions, are deductible as business expenses.

The Court of Appeals rested its decision in these cases on its decision in the *Higgins* case, in which it had held that the management and conservation of investments, as distinguished from active trading or speculation, does not constitute "business". In its

decision in the *Higgins* case, the Court of Appeals stated that its views could not be reconciled with the decision of the Sixth Circuit in *Kales v. Commissioner*, 101 F. (2d) 35.

As stated above, a petition for a writ of certiorari has been filed in this Court in the *Higgins* case (No. 253). The Department of Justice has filed a short memorandum stating that "the respondent does not oppose the granting of a writ of certiorari in this case." It is conceded that the decision in the *Higgins* case "is contrary to the holding of the Circuit Court of Appeals in the *Dupont* case (*Dupont v. Deputy*, 103 F. (2d) 257) and probably cannot be reconciled with the decision in the *Kales* case."

In view of the square conflict created by the decision, there is the probability that a writ of certiorari will be granted in the *Higgins* case. If so, it is respectfully submitted that writs should be issued also in these cases so that the petitioners may have an opportunity to be heard in this Court at the same time.

2. In its decision in the *Kales* case, the Sixth Circuit approved and relied upon the uniform and long continued administrative practice under which ordinary and necessary expenses incurred in the management and conservation of income-producing properties and the production of income therefrom always have been allowed as business expenses. The Second Circuit, in its decision in the *Higgins* case, ignored the administrative practice, possibly because it was not called to its attention in that case. In the instant cases, the Second Circuit referred to such administrative practice, under which trustees' commissions have uniformly been allowed as business expenses,

but refused to follow such practice solely on the ground that "the departmental rulings relied upon by the taxpayer were not promulgated by the Secretary of the Treasury and, therefore, are of little aid in interpreting the statute."

In this respect, the decision of the Court of Appeals conflicts with the decisions of this Court in *Helvering v. Bliss*, 293 U. S. 144, 151, and *McFeely v. Commissioner*, 296 U. S. 102, 108, in both of which departmental rulings not promulgated by the Secretary of the Treasury were accepted by this Court as sufficiently establishing administrative practice.

3. The precise question presented in these cases, as to whether the administration of a trust for investment and reinvestment and the accumulation and reinvestment of income constitutes a business, so that the ordinary and necessary expenses of administering the trust are deductible in computing its net income, is an important question of federal law which has never been, but should be, decided by this Court.

Even after the decisions below in these cases, the Commissioner, we understand, has continued his practice of allowing trustees to deduct *as business expenses* all expenses which he considers to be "ordinary and necessary" to the production of taxable income, but whenever a trustee claims a deduction for any item which the Commissioner does not consider an "ordinary and necessary" expense, the Commissioner invokes the decision in these cases to justify the disallowance of *all claimed business expenses*.

It is submitted that this is an intolerable situation which necessarily leads to utter confusion. A final and definite decision by this Court as to whether or not the administration of trusts constitutes the conduct of business is essential.

If this Court reviews these cases and holds that the petitioners are entitled to deduct their ordinary and necessary business expenses, it then will be necessary for this Court to determine whether the commissions in question, which, in accordance with New York law, were computed on the basis of and paid out of the corpus of the trusts, were ordinary and necessary business expenses.

This is not the time to argue that question. We think there is no answer to the petitioners' contention that such commissions are deductible. That there is at least substantial merit to the contention is shown by the facts that (1) of the nine members of the Board of Tax Appeals who considered the question, five were of the opinion that the commissions were deductible, (2) the Court of Appeals said that the deduction of such commissions "might be permissible", and (3) the Commissioner of Internal Revenue has ruled expressly that such commissions are deductible (S. M. 2463, III-2 Cum. Bull. 91; S. O. 88, 4 Cum. Bull. 119).

For the foregoing reasons, the petitioners respectfully pray that writs of certiorari issue to review the decisions below.

Respectfully submitted,

ROLLIN BROWNE,  
Attorney for Petitioners.

JOHN G. JACKSON, JR.,  
GEORGE CRAVEN,  
MITCHELL, TAYLOR, CAPRON & MARSH,  
JACKSON, FULLER, NASH & BROPHY,  
Of Counsel.

September 6, 1940.

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